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No. 91-794

IN THE
Supreme Court of the United States
OCTOBER TERM, 1992

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of Virginia

BRIEF *AMICUS CURIAE* ON BEHALF OF THE MILITARY COALITION IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Whether this Court's decision in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989), may under any circumstances be "applied" nonretroactively so as to defeat federal retirees' entitlement to refunds of unconstitutional state taxes imposed upon their federal annuities.

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INTEREST OF THE *AMICUS CURIAE*

Pursuant to Rule 37.3 of the Rules of this Court, The Military Coalition (herein "TMC") respectfully submits this brief as *amicus curiae*.[1] TMC is a voluntary association of 24 military-related organizations which was formed six years ago (App. A, 1a). Collectively its constituent organizations represent the interests of over 1,500,000 members, who are retired, reserve and active members of the Uniformed Services of the United States. TMC is dedicated to the purpose of providing a cohesive means for the study and advocacy of issues which impact

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[1] *Amicus* has received the written consents of the parties to the filing of this brief; those consents have been filed with the Clerk of the Court.

upon the maintenance of a strong national defense and the preservation of rights and benefits its varied constituents have earned through years of dedicated service to the United States.

The State of Virginia and approximately thirteen other states continue to refuse to give retroactive effect to this Court's decision in *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989). The resolution of the question presented in this case is vitally important to *amicus*. If the decision below is permitted to stand, military retirees and, indeed, military members on active duty throughout the fifty states will be at risk that rights established by Congress may be arbitrarily abridged by any state solely on the basis of local political considerations. *Amicus* has supported the enactment of several measures by Congress which prohibit discrimination of the type upheld by the decision below. Thus, *amicus* has a unique perspective on the question presented by this case as well as a vital interest in its proper resolution.

SUMMARY OF THE ARGUMENT

In the decision below, the Virginia Supreme Court misconceived its analytical task. Under the Supremacy Clause, its sole function was to enforce 4 U.S.C. § 111 in accordance with its terms. Since the Virginia scheme of taxation violated Congress' limited consent to the taxation of federal compensation, the court below erred in failing to find that the Virginia taxing scheme had been pre-empted.

Upon remand from this Court in the October Term of 1990, the court below also erred in refusing to apply this Court's judgment in *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2239 (1991). Under *Beam*, it is unmistakable that state courts are obligated to give this Court's decision in *Davis* retroactive effect.

Alternatively, if this Court concludes that a prospectivity analysis is appropriate in determining the effect of

unambiguous Congressional enactments, under the three-prong test it was error for the Virginia Supreme Court to refuse to give 4 U.S.C. § 111, as construed in *Davis*, retroactive effect.

Under the first prong, there is no new principle. 4 U.S.C. § 111 merely codifies this Court's decisions. Similarly, the State's claim of reliance on its own statute is inadequate to satisfy this threshold prong. This is so, in part, because Virginia ignored its own 1982 determination that its scheme was inequitable.

Under the second and third prongs, the State has demonstrated nothing which would justify refusing to give effect to a lawful enactment of Congress. Indeed, under the circumstances of this case, the failure to give *Davis* retroactive effect results in a new violation of 4 U.S.C. § 111.

With respect to the equities, Virginia comes to this Court with unclean hands. The burdens, if any, in this case are of the State's own making and are directly related to considered parochial choices which its legislature has voluntarily made. Moreover, the burden, which Virginia claims in this case, is attributable in large measure to its attempt to finance its choices by singling out the petitioners to shoulder a tax burden that similarly situated citizens of Virginia have not and are not being required to bear.

Finally, it is clear that the decisions of this Court preclude the result ordered below. Virginia seeks to retain the benefits of 4 U.S.C. § 111, while at the same time it claims that, as to the petitioners, 4 U.S.C. § 111 was not the law. A state cannot retain the benefits of legislation and at the same time attack the validity of the same act. Similarly, as to tax year 1988, Virginia seeks relief from a burden of its own making. Under the precedents of this Court, such relief is foreclosed.

Since none of the factors for prospectivity are satisfied and since Virginia is precluded from invoking the defense

in the first instance, 4 U.S.C. § 111, as construed in *Davis*, should be given retroactive effect. The Virginia legislature has waived all procedural bars to the refunds claimed. As a matter of federal law, *amicus* urges this Court in its mandate to compel Virginia to pay refunds upon remand.

ARGUMENT

I. THE COURT BELOW MISCONCEIVED THE PROPER ANALYTICAL TASK.

Amicus respectfully submits that the Virginia Supreme Court "misconceived the appropriate analytical task," *Patterson v. Shumate*, 112 S. Ct. 2242, 2248 n.4 (1992), in reaching its holding that "the *Davis* decision is not to be applied retroactively." Pet. App. at 17a. Given the clarity of the statutory provision at issue in *Davis*, the decisions of this Court establish that "the sole function" of the court below should have been "to enforce [the statute] according to its terms." *West Virginia Univ. Hosp., Inc. v. Casey*, 111 S. Ct. 1138, 1147 (1991) (citations omitted). *See also Patterson v. Shumate*, 112 S. Ct. at 2247; *United States v. Ron Pair Enter., Inc.*, 489 U.S. 235, 241 (1989).[2]

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[2] Virginia's defense in this case was based upon an appeal to parochial considerations. (J.A. 32-49). However, as Justice Holmes observed:

> Great cases like hard cases make bad law. For great cases are called great, not by reason of their real importance in shaping the law of the future, but because of some accident of immediate overwhelming interest which appeals to the feelings and distorts the judgment. These immediate interests exercise a kind of hydraulic pressure which makes what previously was clear seem doubtful, and before which even well settled principles of law will bend. What we have to do in this case is to find the meaning of some not very difficult words. We must try, I have tried, to do it with the same freedom of natural and spontaneous interpretation that one would be sure of if the same question arose upon an indictment for a similar act which excited no public attention, and was of importance only to a prisoner before the court. Furthermore, while at times judges need for their work the training of economists or statesmen, and must act in view of their foresight of consequences, *yet when their task is to interpret and apply the words of a statute, their function is merely academic to begin with—to read English intelligently—and a consideration of consequences comes into play, if at all, only when the meaning of the words used is open to reasonable doubt.*

Northern Sec. Co. v. United States, 193 U.S. 197, 400-01 (1904) (Holmes, J., dissenting) (emphasis added).

In exercising its judicial function to enforce 4 U.S.C. § 111, the Virginia Supreme Court should have given effect to the considered decision of Congress in establishing the effective date of the Act. *See* Public Salary Tax Act of 1939, Title I, § 4 (App. B at 8a); *Meredith v. State Tax Comm'n*, 163 Or. 305, 312-13, 96 P.2d 1082 (1939) (recognizing that the effective date of the Act as enacted by Congress is controlling.). A state court is "'not at liberty to create an exception where Congress has declined to do so.'" *Freytag v. Commissioner*, 111 S. Ct. 2631, 2636 (1991) (citation omitted). *See also Patterson*, 112 S. Ct. at 2250. The pre-emption of Virginia's discriminatory tax was "compelled". *See Adams Fruit Co. v. Barrett*, 494 U.S. 638, 642 (1990) (citation omitted). *See also Gregory v. Ashcroft*, 111 S. Ct. 2395, 2409 (1991) (White, J., dissenting) ("'The relative importance to the State of its own law is not material when there is a conflict with a valid federal law, for the framers of our Constitution provided that the federal law must prevail.'") (citations omitted).

Amicus also submits that the decision of the court below was foreclosed by its obligations under the Supremacy Clause as well as principles of *stare decisis*. *See McKesson v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 29 (1990) ("State courts must interpret and enforce faithfully the 'supreme Law of the Land' . . . ."). *See also Planned Parenthood of South-*

eastern Pennsylvania v. Casey, 60 U.S.L.W. 4795, 4817 (1992) (Stevens, J., concurring in part and dissenting in part) ("[T]he doctrine of *stare decisis* has controlling significance in a case of this kind, notwithstanding an individual justice's concerns about the merits."). Although there were several opinions in *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2238 (1991), the mandate of this Court's judgment in *Beam* is unmistakable:

> [A]ny consideration of remedial issues necessarily implies that the precedential question has been settled to the effect that the rule of law will apply to the parties before the Court. . . . Because the Court in *Bacchus* remanded the case solely for consideration of the pass-through defense, it thus should be read as having retroactively applied the rule there decided. . . . *Cf. Davis v. Michigan Dep't of Treasury*, 489 U.S. 803, 817, 109 S. Ct. 1500, 1508, 103 L. Ed. 2d 891 (1989).

Id. at 2445-46 (footnote and citations omitted).

In *Davis*, Michigan's concession as to the appropriate retroactive remedy would have been of no moment unless this Court first had found the scheme unlawful for the years at issue therein (1979-1984). *Davis*, 489 U.S. at 806-07. *Cf. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue and Fin.*, 60 U.S.L.W. 4582, 4586 (1992) (Rehnquist, C.J., dissenting) ("[A] stipulation between parties cannot bind this Court on a question of law."). *Amicus* submits that after this Court had applied the rule of law to the litigants in *Davis*, it was erorr for the Virginia Supreme Court to use the pretext of the prospectivity defense to deny the Petitioners retroactive relief. *Beam*, 111 S. Ct. at 2448.

II. ALTERNATIVELY, ASSUMING THIS COURT DETERMINES THAT A PROSPECTIVITY ANALYSIS MAY BE APPLIED IN THIS CASE, *DAVIS* SHOULD BE GIVEN RETROACTIVE EFFECT.

Assuming this Court is persuaded that it should apply the prospectivity test of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), *amicus* submits that an even-handed *Chevron* analysis requires that the provisions of 4 U.S.C. § 111 as construed in *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989), be given retroactive effect.

A. *Davis* Did Not Establish a New Principle of Law. Therefore, the Threshold Prong for Prospectivity Is Not Satistfied.

The first prong of the prospectivity test requires that "the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed." *Ashland Oil, Inc. v. Caryl*, 110 S. Ct. 3202, 3203 (1990) (per curiam) (citations omitted). Decisions must be retroactively applied if this threshold test is not met. *Id.* at 3205. The test under the first prong is a rigorous one, which is narrowly applied. *Id.*[3] Since *Davis* "*was not revolutionary*," it does not meet the first prong. *Id.* (emphasis added).

The State contends that *Davis* decided an issue of first impression whose resolution was not clearly foreshadowed. It supports this assertion by contending that it

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[3] In applying its decision in *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984), retroactively to invalidate a West Virginia tax which had been in effect for over 50 years, the Court refused to characterize its decision in Armco as having "overrul[ed] clear past precedent on which litigants may have relied" merely because it was inconsistent with a nearly identical decision in the case of *Columbia Gas Transmission Corp. v. Rose*, 459 U.S. 807 (1982), which the Court dismissed for want of a substantial federal question a year prior to the Court's decision in *Armco*. *Id.* at 3205 n*.

relied upon a presumptively valid taxing statute. (Pet. App. C at 10a). However, "where the power to tax is not unlimited, validity is not established by the mere imposition of a tax." *Mullaney v. Anderson*, 342 U.S. 415, 418 (1952).[4]

Contrary to the State's assertion, since 1939 it has been settled that the States only had the power to impose "nondiscriminatory" taxes upon the "compensation" of employees of the United States. *Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 487 (1939). In so holding, the Court observed that it perceived "no basis for a difference in result whether the taxed income be salary or some *other form of compensation* . . . ." *Id.* at 486 (emphasis added). This rule was codified in the Public Salary Tax Act of 1939. *See Davis*, 489 U.S. at 812.[5] Since then, nothing in the law has changed which would permit Virginia to invoke the limited prospectivity exception.

In resolving the question of statutory construction at issue in *Davis*, this Court applied settled principles under the doctrine of intergovernmental immunity. First, implicit in the Court's analysis in *Davis* was recognition

[4] Analytically, Virginia does not, in fact, seek the application of the prospectivity exception. Virginia really is asking this Court to switch off the rule of law and grant it an exemption from the application of the unambiguous provisions of 4 U.S.C. § 111 so that it can continue to enforce its invalid scheme for all tax years prior to the 1989 tax year.

[5] *See also* S. Rep. No. 112, 76th Cong., 1st Sess. at 9 (1939) ("[T]he proposal before us provides only for nondiscriminatory taxation of the compensation of public employees and is reciprocal in nature. Thus, whatever burden might be passed on to one government because of the taxation of its employees' compensation by another governmental unit would, in a measure at least, be offset by the converse application of the proposal."); *The Taxation of Municipal Obligations and Salaries*, A Report of the Committee on Taxation of Municipal Obligations and Salaries, Municipal Law Section of the American Bar Association, at 13 (July 11, 1939) (*Graves* preserves the rule of intergovernmental tax immunity).

that the law has always been that the federal government "possesses the power to enact statutes immunizing those with who it deals from state taxation even if [the] intergovernmental tax immunity doctrine would not otherwise confer an immunity." *South Carolina v. Baker*, 485 U.S. 505, 519 n.11 (1988) (citing *Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 478 (1939)). Second, a State is required to treat "those who deal with the Government as well as it treats those with whom it deals itself." *Phillips Chem. Co. v. Dumas Sch. Dist.*, 361 U.S. 376, 385 (1960). Third, "[t]he imposition of a heavier tax burden on [those who deal with one sovereign] than is imposed on [those who deal with the other] must be justified by significant differences between the two classes." *Id.* at 383.

These settled principles are of particular significance because they have been consistently applied in earlier cases involving the doctrine of intergovernmental tax immunity. *See, e.g., United States v. City of Manassas*, 830 F.2d 530 (4th Cir. 1987), *aff'd*, 485 U.S. 1017 (1988); *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983); *Chase Manhattan Bank, N.A. v. Finance Admin.*, 440 U.S. 447 (1979) (per curiam); *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744, *reh'g denied*, 366 U.S. 947 (1961). *See also Forbes, Inc. v. Department of Fin.*, 66 N.Y.2d 243, 487 N.E.2d 251 (1985), *cert. denied*, 475 U.S. 1109 (1986).

Virginia's contention that *Davis* was not clearly foreshadowed is unpersuasive.[6] *Davis* is replete with analysis which unequivocally demonstrates that the law in this

[6] The State contends that the rule of *Davis* should not be applied here. Under *Chevron*, presumably then this case would be controlled by the pre-*Davis* old rule of law. Ignoring the plain text of 4 U.S.C. § 111, the old rule of law in such a circumstance would be *Graves*, *supra*, and *Phillips Chem. Co.*, *supra*. If the court below had applied the old rule of law, the result reached under *Graves* would have been identical to that of the *Davis* decision.

area was clearly established prior to *Davis*. Significantly, Michigan unsuccessfully attempted to persuade this Court to depart from clearly established law. Michigan's invitation was rejected: "The state offers no reason for departing from this *settled rule*, and we decline to do so." *Davis*, 489 U.S. at 815 (emphasis added). Moreover, *Davis* begins with the dispositive holding that:

> [T]he overall meaning of § 111 is *unmistakable*: it waives whatever immunity past and present federal employees would otherwise enjoy from state taxation of . . . retirement benefits . . . paid on account of their employment with the Federal Government, except to the extent that such taxation discriminates on account of the source of compensation.

Id. at 810 (emphasis added). Any other "hypertechnical reading" of the statute would be "implausible at best." *Id.* at 809-10. *Davis* did not announce a new principle of law. It merely affirmed, under settled legal principles, that Mr. Davis, like the federal retirees here, cannot legally be subjected to a discriminatory state tax.

The Court in *Davis* also emphasized that the long standing principle of intergovernmental tax immunity, as codified in 4 U.S.C. § 111, has its "genesis in *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819)." *Davis*, 489 U.S. at 810. In *M'Culloch*, the Court held that the State of Maryland could not impose a discriminatory tax on a federal instrumentality of the United States. The *Davis* court further noted that, after the decision in *Graves v. New York, supra*:

> [I]ntergovernmental tax immunity barred only those taxes that were imposed directly on one sovereign by the other or that discriminated against a sovereign or *those with whom it dealt*.

Davis, 489 U.S. at 811 (emphahis added). The *Davis* court stated that the nondiscrimination component of the constitutional immunity doctrine has, from the time of *M'Culloch v. Maryland*, barred taxes that "'operat[e] so as to discriminate against the Government or those

with whom it deals.'" *Id.* at 812 (citations omitted). The Court also observed that 4 U.S.C. § 111 was drafted "against the backdrop" of this Court's earlier tax decisions and, as such, is "coextensive with the . . . modern constitutional doctrine of intergovernmental tax immunity." *Id.* at 813.

Rejecting Michigan's argument that individuals should not receive protection of the constitutional doctrine of intergovernmental imunity, the *Davis* decision held that "*all precedent* is to the contrary." *Id.* at 814 (emphasis added). This statement evidences two crucial points which *amicus* submits compel the conclusion that the law applied in *Davis* was clearly foreshadowed. First, it shows the existence of prior decisions directly on point. The *Davis* Court listed no fewer than five of its tax decisions dating back to 1842 in support of the proposition that federal retirees may not be taxed discriminatorily. *Id.* at 815. Second, it demonstrates that the law in this area has been consistent. *Id.* This explains why the Court viewed the law as "settled." The *Davis* decision was an inevitable and unmistakable conclusion based upon existing precedent. Accordingly, *Davis* does not represent "such an abrupt and fundamental shift in doctrine as to constitute an entirely new rule . . . ." *Hanover Shoe, Inc. v. United States Shoe Mach. Corp.*, 392 U.S. 481, 498 (1968).

In the wake of *Davis*, some states, similar to Michigan's argument before this Court, initially feigned surprise at the *Davis* decision because they claimed that they did not realize that the provisions of § 111 prohibiting discrimination in the taxation of the compensation of a federal employee included discriminatory taxation of pensions.[7] Stated another way, these states claimed that

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[7] Indeed, Michigan's assertion in *Davis* was nothing more than a "'cloak for discrimination'" against federal pension benefits. *Barker v. Kansas*, 112 S. Ct. 1619, 1626 (1992) (citation omitted). Michigan, like several other states, has justified the constitution-

they did not realize that pensions were "compensation." However, it is clear that Virginia recognized that the taxation of federal pensions is the taxation of compensation for personal services rendered to the United States. *See Report of the House Finance Retirement Subcommittee to the Governor and the General Assembly of Virginia*, December, 1982, at 8 ("Although further differences in treatment among the different classes of retirees can be listed, tax laws should not distinguish the components of *compensation* . . . .") (emphasis added). (App. D at 15a).

Although Virginia should be precluded from reasserting here the hypertechnical argument of Michigan, it is indisputable that the *Davis* Court's holding that "retirement benefits are deferred compensation" for purposes of 4 U.S.C. § 111 was clearly mandated by the plain language of the statute. *Davis*, 489 U.S. at 808.

The term "compensation for personal service", as used in the Internal Revenue Code at the time of the adoption of the Public Salary Tax Act included pensions,[8] and more specifically, the *pensions of retired government employees.*[9] In addition, based upon the doctrine of intergovernmental tax immunity, state pensions, because they represented compensation, had consistently been excluded from federal income taxation prior to the passage of the Public Salary Act of 1939.[10]

Virginia accepted and understood that pensions were compensation for purposes of Title II of the Act. This title provided total immunity from the federal income tax for employees and retirees of Virginia's state and local subdivisions with respect to their "compensation," including pensions for personal services rendered to state and local governments for all years prior to 1939. *See* Public Salary Tax Act of 1939, Ch. 59, Title II (App. B at 9a-12a). The State also understood that pensions were compensation for purposes of Title I of the Act, because before 1939, the State could not and did not tax any "other form of [federal] compensation." *Graves*, 306 U.S. at 486. It is indisputable that pensions are compensation for personal services and that state and federal pensions have always been subject to the doctrine of intergovernmental tax immunity and § 111.[11] Against

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ality of its income tax of former residents on the basis that pensions are deferred compensation for services rendered at an earlier point in time. *See Molter v. Department of Treasury*, No. 125786, 1992 Mich. App. Lexis 131 (Ct. App. April 6, 1992). *See also*, Op. Ariz. Att'y Gen. No. 60-9-L (1959) (federal pension benefits represent deferred compensation for personal services as an officer or employee of the federal government) (App. C at 13a-14a).

[8] The Public Salary Tax Act specified that its "terms * * * shall have the same meaning as when used in Chapter I of the Internal Revenue Code." *Id.*, Title II, § 206. (App. B at 11a).

[9] Pensions or retirement allowances paid by the United States have been deemed part of the recipient's compensation for personal services since 1919. *See, e.g.*, Treas. Reg. 45, Art. 32 (1919); Treas. Reg. 86, Art. 22(a)-2 (1935); Treas. Reg. 101, Art. 22(a)-2 (1930); *see also* Treas. Reg. § 1.61-2(a)(1). It has been clear from the date of the enactment of the United States Civil Service Retirement System in 1920 that the pension payments made by the federal government to its retired employees are compensation for personal services. *See* 59 Cong. Rec. 6300 (April 29, 1920) (statement of Representative Hamil: "Pensions are not gratuities * * * they should be looked upon as deferred wages—as payments of wages which were not disbursed at the time they were earned.").

[10] I.T. 1607, II-2 C.B. 71 (1923) ("Inasmuch as salaries and wages received by officers and employees of a State are exempt from taxation . . . it is held that the retirement allowance given employees of the State of New York under the New York State Employees' Retirement System represents compensation for past services rendered and is exempt from taxation."); I.T. 2669, XII-1 C.B. 68 (1933) (pensions paid to a person who rendered services as an officer or employee of a State or political subdivision thereof "represent compensation paid for past services rendered, and since the compensation in such cases was exempt from Federal income tax the pensions are also exempt from Federal income tax.").

[11] Federal tax cases have also consistently held that pensions are compensation for personal services. *Hooker v. Hoey*, 27 F. Supp. 489, 490 (S.D.N.Y.), *aff'd*, 107 F.2d 1016 (2d Cir. 1939); *Sharpe*

this background the State's assertion that *Davis* was a surprise is untenable.[12]

Virginia's claimed reliance interest in its statute is mere "cant." *Commissioner v. Newman*, 159 F.2d 848, 851 (2d Cir.), *cert. denied*, 331 U.S. 859 (1947) (Hand, J., dissenting). Virginia's contention ignores the practical realities of an income tax. Unlike property, use or transaction taxes, Virginia's income tax is wholly subject to the vagaries of life. Setting aside constitutional issues, the income tax may be avoided or mitigated by proper planning and/or the occurrence of a host of unforeseen/unpredictable events (*e.g.*, catastrophic medical expenses, casualty losses, bad investments, business losses, charibtable donations and in some instances, even gambling

v. United States, 54-2 USTC (CCH) ¶ 46,902 (W.D. Wash. 1954) (retirement payments to taxpayer were in consideration of his status as an employee of the State of Washington and were taxable); *Simpson v. United States*, 236 F. Supp. 433 (D. Conn. 1964). *See also* Rev. Rul. 56-82, 1956-1 C.B. 59 (recognizing that the Public Salary Tax Act limits the federal taxation of state pensions); Treas. Reg. § 1.161-2(a) (defining compensation for services to include pensions).

[12] Even without the intervention of the *Davis* decision, the prevailing authority of the states' highest courts and Virginia's own administrative rulings clearly foreshadowed the outcome of the issue. *See, e.g.*, Ruling of Commissioner, P.D. 88-7, [2 Va.] St. Tax Rptr. (CCH) para. 201-546; *Forbes, Inc. v. Department of Fin.*, 66 N.Y.2d 243, 487 N.E.2d 251 (1985), *cert. denied*, 475 U.S. 1109 (1986); *Brown v. Franchise Tax Bd.*, 197 Cal. App. 3d 300, 242 Cal. Rptr. 810 (1987); *Andras v. Department of Revenue*, 154 Ill. App. 3d 37, 506 N.E.2d 439 (1987), *cert. denied*, 485 U.S. 960 (1988); *Commissioner of Revenue v. Plymouth Home Nat'l Bank*, 394 Mass. 66, 473 N.E.2d 1139 (1985) (decided under state law); *Matz v. Department of Treasury*, 155 Mich. App. 778, 401 N.W.2d 62 (1986); *In re Sawyer Estate*, 149 Vt. 541, 546 A.2d 784 (1987); *Capital Preservation Fund v. Department of Revenue*, 145 Wis. 2d 841, 429 N.W.2d 551 (Ct. App. 1988). *See also Borg v. Department of Revenue*, 308 Or. 34, 774 P.2d 1099, 1101-02 (1989) ("The nondiscrimiantion rule of *Davis v. Michigan Dep't of Treasury, supra*, requires the same result.").

losses). *See, e.g.*, Code § 58.1-322 D.1.a. (App. E at 17a); Ruling of Commissioner, P.D. 88-30, [2 Va.] St. Tax Rptr. (CCH) para. 201-563 (permitting deduction of gambling losses and related expenses). Moreover, even when the tax is paid, the state has no settled expectation or reliance on the revenues collected until the applicable limitations periods for refunds and carryovers (carrybacks or carryforwards) have expired. *See e.g.*, Ruling of Commissioner, P.D. 87-253, [2 Va.] St. Tax Rptr. (CCH) para. 201-519 (permitting net operating loss carryback from 1985 to 1982 and abating 1982 assessment); Ruling of Commissioner, P.D. 90-217, *Id.* at para. 201-930 (permitting net operating loss carryback from 1989 to 1986); Ruling of Commissioner, P.D. 90-11, *Id.* at para. 201-844 (authorizing refund filed within three years from the extended date of the original return).

Certainly, Virginia did not presume that it would be able to defend its scheme from substantive attack under 4 U.S.C. § 111 on the basis of the jurisdictional defense asserted in *Waldron v. Collins*, 788 F.2d 736 (11th Cir.), *cert. denied*, 479 U.S. 884 (1986). Similarly, by at least October of 1986, Virginia should have been on notice of the parameters of the relevant inquiry governing state taxing schemes which discriminate against those who deal with the federal government. *See United States v. City of Manassas*, 830 F.2d 530 (4th Cir. 1987), *aff'd*, 485 U.S. 1017 (1988).[13]

Virginia's attempt to enhance its claimed reliance interest from the lack of litigation is also disingenuous. First, there is no protest requirement in Virginia. More significantly, however, Virginia's argument is untrue. Since at least 1982, there has been significant, widespread protest by federal retirees to Virginia's discriminatory

[13] This case was argued to the Fourth Circuit on October 10, 1986 and the Virginia Attorney General appeared on brief for the defendants, which included the State Tax Commissioner of the Commonwealth of Virginia. *Id.*

income tax scheme of federal pensions. In response to this protest, a legislative committee was appointed to study the issue. *See Report of the House Finance Retirement Subcommittee to The Governor and The General Assembly of Virginia*, December, 1982, at 4 ("The subcommittee was to examine in particular the individual income tax treatment of military and civil service retirement benefits."). (App. D, 15a). After taxpayer hearings, *Id.* at 23, the committee concluded that remedial legislation was required to cure the "inequity" of the income tax scheme and recommended legislation that would treat "*all* retirees equally." *Id.* at 24. Certainly, petitioners cannot be faulted for having first invoked the political process, albeit unsuccessfully. Stated another way, the State cannot claim a reliance interest where it has disregarded the recommendations of its own political process.[14]

In addition, the fact that Virginia's discriminatory scheme has been in effect for many years does not give rise to a reliance interest under *Chevron*. *See Ashland Oil*, 110 S. Ct. at 3205 n.*. In a similar vein, it is

[14] The futile efforts of federal retirees to obtain pre-*Davis* legisltaive relief from discriminatory state taxation were not unique to Virginia. *See, e.g.*, Petitioners' Reply Brief at 2, *Barker v. Kansas*, 112 S. Ct. 1619 (1992) (No. 91-375) (establishing ongoing efforts from 1971); Index of Record 111, 121, 125, 239, *Bohn v. Waddell*, 164 Ariz. 74, 790 P.2d 772 (1990), *aff'd on reconsideration*, 167 Ariz. 344, 807 P.2d 1 (1991), *appeal pending*, No. 1 CA-TX 91-008 (establishing ongoing efforts from the late 70's); Exhibits 10 through 24, *Hagge v. Iowa State Dep't of Revenue and Fin.*, Iowa District Court, Linn County, No. LA 20859 (establishing ongoing efforts from at least 1976); Petitioners' Motion for Recusal, *Hogan v. Musolf*, Wisconsin Tax Appeals Commission, No. 91-I-386 (establishing ongoing efforts from the mid-60's); Exhibits 7 through 33, *Ponthier v. Louisiana Dep't of Revenue*, Louisiana Board of Tax Appeals, No. 3396 (establishing ongoing efforts from the late 70's); Record on Appeal 349-365, *Swanson v. Powers*, No. 89-282-CIV-5H (E.D.N.C. 1990), *rev'd in part*, 937 F.2d 965 (4th Cir. 1991), *cert. denied*, 112 S. Ct. 871 (1992) (establishing ongoing efforts from the late 70's).

clear that the sheer number of states violating a Congressional mandate has never been a proper justification for unlawful state enactments. *See South Carolina v. Baker*, 485 U.S. 505, 515 (1988).

Since the State cannot satisfy the threshold test of a "wholly new issue of first impression," *Davis* must be applied retroactively. *See Ashland Oil*, 110 S. Ct. at 3205. *See also United States v. City of Spokane*, 918 F.2d 84, 89 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 2888 (1991) ("Our decision striking down this tax does not meet the tests of nonretroactivity. We overrule no precedent and we do not decide an issue of first impression.").

B. Retroactive Application of *Davis* Will Further the Purposes Behind 4 U.S.C. § 111 and the Doctrine of Intergovernmental Tax Immunity.

Under the second prong of *Chevron*, a court "'must weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation.'" *Chevron Oil Co. v. Huson*, 404 U.S. 97, 106-07 (1971) (citations omitted).

The State contends, and the court below summarily concluded, that, because the state statute at issue was repeated prospectively, this prong had been satisfied. (Pet. App. C at 12a). This summary observation can hardly be deemed adequate.

Had a meaningful inquiry been undertaken in the decision below, the Virginia Supreme Court would have been forced to conclude that the purpose of the rule could be furthered only by retrospective operation. The court's failure to apply *Davis* retroactively, in fact, frustrates the operation of the rule.

In *Trinityfarm Constr. Co. v. Grosjean*, 291 U.S. 466, *reh'g denied*, 292 U.S. 604 (1934), the Court observed that:

> [The] application [of the intergovernmental tax immunity doctrine] does not depend upon the *amount of exaction, the weight of the burden or the resulting interference with sovereign independence.* Where it applies, the principle is an absolute one wholly unaffected by matters or distinctions of degree . . . . Its right application is essential to the orderly conduct of the national and state governments and the attainment of justice between them.

Id. at 471 (emphasis added).

As recently observed by the Ninth Circuit in an analogous case, the rule of law implicated in this case involves a "fundamental principle," *United States v. City of Spokane*, 918 F.2d 84, 89 (9th Cir. 1990), which had its genesis in *M'Culloch v. Maryland*, 17 U.S. 316 (1819). *See also Graves v. New York ex rel. O'Keefe*, 306 U.S. 466 (1939). Retroactive application of the decision here "will surely foster a proper respect for that principle," *United States v. City of Spokane*, 918 F.2d at 89, by encouraging states to tread carefully when they impose taxes upon those who deal with the federal government.[15] It appears that this principle is now observed only in the breach. *See Cambridge State Bank v. James*, 480 N.W.2d 647 (Minn. 1992), *petition for cert. pending*, No. 91-2047.[16]

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[15] Retroactive application here will also have the salutary effect of reminding state courts of their obligation under the Supremacy Clause. *See McKesson*, 496 U.S. at 29 ("State courts must interpret and enforce faithfully the 'supreme Law of the Land . . . .'"). It will serve to deter future "result-oriented decision[s] arrived at for the [sole] purpose of protecting the state's coffers." *Sheehy v. State, Dep't of Revenue*, 820 P.2d 1257, 1269 (Mont. 1991), *petition for cert. pending*, No. 91-1437 (Trieweiles, J., dissenting).

[16] This is further illustrated by the conduct of the states in the context of *Davis*-related litigation. Two months after the commencement of *Davis*-related litigation and the confirmation of the estimate of refunds mandated thereunder, the Wisconsin legislature enacted 1989 Wisconsin Act 31, an election year refund program, thereby dissipating a $250 million unappropriated surplus. The State then proceeded to defend, *inter alia*, on the ground that its refund obligation should be excused under *Chevron* because the State could not afford to pay refunds. TR. 5, 13, 15, *Hogan v. Musolf*, 163 Wis. 2d 1, 471 N.W.2d 216 (1991), *cert. denied*, 112 S. Ct. 867 (1992). In Alabama *Davis*-related litigation, the State attempted to defend on a similar basis, notwithstanding the fact that there was a surplus in excess of $53 million in the fund from which refunds were to be paid. *Rinehart v. Sizemore*, No. CV-89-704-M, *slip op.* at 5-6 (Montgomery County Ct., Ala. October 10, 1990), *aff'd*, 1992 Alabama Civ. App. Lexis 183 (Ala. Civ. App. February 7, 1992). Arizona has pursued a similar strategy, while the defendants there continue to overfund their own state retirement fund, which at the commencement of the *Davis*-related case, was and is overfunded in excess of $1 billion *See* Arizona State Retirement System Annual Report June 30, 1990 at 30, *Bohn v. Waddell*, 164 Ariz. 74, 790 P.2d 772 (1990), *aff'd on reconsideration*, 167 Ariz. 344, 807 P.2d 1 (1991), *appeal pending*, No. 1 CA-TX 91-008.

A failure to apply *Davis* retroactively will also serve to eviscerate the careful balance struck under Title II of the Public Salary Tax Act of 1939 (App. B at 9a-12a). It is beyond question that state retirees have and continue to enjoy the benefits of this legislation. *See, e.g.*, Rev. Rul. 56-82, 1956-1 C.B. 59 (recognizing the exclusion for federal tax purposes of current state pension benefits attributable to certain pre-1939 contributions). Yet, if the decision below is permitted to stand, the principle, which the states will extrapolate from this case, will be that the states may freely claim the benefits of any federal legislation, but will be free to avoid any undesired burdens of such legislation by merely invoking the prospective defense.

Similarly, if the decision below is permitted to stand, the rights granted to federal retirees under 4 U.S.C. § 111 would be extinguished. As this Court has recently observed:

> [O]ur government 'has been emphatically termed a government of laws, and not of men. It will certainly cease to deserve this high appellation, if the laws furnish no remedy for the violation of a vested legal right.'

Franklin v. Gwinnett, 112 S. Ct. 1028, 1033 (1992) (quoting *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 163 (1803)). Here, the overriding purpose of the constitutional principle and the Act—to prevent discriminatory taxation—will be retarded if *Davis* is not given retroactive effect. Such a result "would harm separation of powers principles . . . by giving judges the power to render inutile" rights conferred by Congress. *See Franklin v. Gwinnett*, 112 S. Ct. at 1029.

In addition, if the decision below is permitted to stand, the interests of the United States would also be compromised. For over four decades, Virginia reduced its employment costs at the expense of the federal treasury. *See Davis*, 489 U.S. at 815 n.4. During that same period of time, it misappropriated substantial federal revenues by virtue of the discriminatory tax imposed upon federal retirees. These state exactions were deducted by numerous federal retirees under 26 U.S.C. § 164, directly reducing federal income tax collections for each of those years. (App. F at 23a).[17] Refunds of these taxes now will enable the federal government to recover part of the federal revenues misappropriated by Virginia in past years. Under the Tax Benefit Doctrine and section 111 of the Internal Revenue Code, any refund ordered will be subject to federal tax in the year received. (App. F at 23a). *See also* Rev. Rul. 79-315, 1979-2 C.B. 27. As a consequence of the Virginia Supreme Court's refusal to order refunds, the United States is currently being denied these tax revenues—revenues to which the United States is clearly entitled. The diversion of these revenues by Virginia represents a new violation of the doctrine of

[17] Approximately 35 million households took this itemized deduction on their 1987 federal tax returns. Based on data of the Internal Revenue Service for 1987, over 50% of households that deducted state and local taxes had incomes under $40,000 and 68% had incomes under $50,000. *See* Individual Income Tax Returns 1987, I.R.S. Pub. 1304 (rev. 8-90).

intergovernmental tax immunity.[18] *See Davis, supra*, 815 n.4.

C. Weighing the Equities Compels the Retroactive Application of *Davis*.

With respect to the third prong of *Chevron*, a court weighs the "inequity imposed by retroactive application" for the purpose of determining whether a decision will produce "substantial inequitable results if applied retroactively." *Chevron Oil Co. v. Huson*, 404 U.S. at 107. In the decision below, there was no weighing. The Virginia Supreme Court's analysis under this prong is virtually nonexistent. (Pet. App. C at 12a-14a). It consisted solely of the alleged financial burden upon the state. However, the relevant equities are far broader in this case.

The Virginia Supreme Court appears to have been persuaded by the State's contention that it is somehow inequitable for a state to be required to refund to its citizens taxes which have been unlawfully collected. This contention is breathtaking. Virginia "cannot object to a refund here just because it has other ideas about how to spend the funds." *McKesson*, 496 U.S. at 51 n.35 (1990). *See Swanson v. State*, 329 N.C. 576, 588, 407 S.E.2d 791, 797, *reh'g granted*, 330 N.C. 445, 410 S.E.2d 498, *adhered to on reh'g*, 330 N.C. 390, 410 S.E.2d 490 (1991), *petition for cert. pending*, No. 91-1436 (Mitchell, J., dissenting) ("There simply is nothing 'inequitable' or wrong about ordering that the state not pick a taxpayer's pocket or in requiring it to return the money when it is caught doing so.").

[18] In contrast to the State of Virginia, during this same period, the Internal Revenue Service has consistently adhered to the doctrine of intergovernmental tax immunity and the provisions of the Public Salary Tax Act of 1939 by recognizing that the part of *current* pension payments received by state and local retirees, which is attributable to employer contributions for years prior to 1939, is exempt from the federal income tax in accordance with the requirements of the Act. *See* Rev. Rul. 56-82, 1956-1 C.B. 59; Rev. Rul. 57-75, 1957-1 C.B. 28.

Similar to its claimed reliance interests, Virginia's equitable claims are grossly exaggerated. The refund right implicated here arises under the state's general individual income tax. Under that tax, just like the federal income tax, it is every citizen's right to avoid the tax in the first instance. As observed by Judge Learned Hand in a famous dissent:

> Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor, and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.

Commissioner v. Newman, 159 F.2d 848, 850-51 (2d Cir.), *cert. denied*, 331 U.S. 859 (1947). It is a strange conception of equity which would permit the State to single out these claimants and deny them refunds on equitable grounds for an unlawful tax, when all other individual taxpayers of the state are free to arrange their affairs to avoid or minimize lawful taxes in the first instance.

Virginia's claims of fiscal burden demonstrate nothing. The State routinely processes and awards in excess of 1.5 million refund claims annually. For example, in the fiscal year ended July 1, 1988, the State paid 1,780,498 taxpayer refund claims, totalling $360 million. *See Virginia Department of Taxation Annual Report, Fiscal Year 1988*, at 11.[19] (App. G at 25a). The State identifies no principle, and *amicus* submits that there is none, which permits the State to single out the petitioners for the purpose of balancing its budget, particularly, where no other individual taxpayer has been required to do so.

[19] This amount is understated since individual taxpayers may, by adjustment of withholding and/or estimated tax payments, to a large extent self-administer their own *de facto* refunds in accordance with their own tax planning.

In addition, in its defense of this case, the State has conveniently ignored the additional "general fund individual income tax *windfall*" that it has realized as the result of the *unforeseen* revenue enhancement provided to the state by virtue of its piggyback adoption of the Federal Tax Reform Act of 1986. At the time this case was tried, this individual income tax *windfall* was estimated to provide the state with unanticipated additional individual income tax revenues of over $175 million between fiscal year 1988 and fiscal year 1990. *See Virginia Department of Taxation Annual Report Fiscal Year 1989* at 5. (App. G at 26a). Viewed objectively, Virginia's claim of inequity amounts to nothing more than the fact that its legislature made the political choice in 1989 to maintain its ranking as the fifth lowest tax burden in the United States by enacting an additional tax cut of $156.1 million (J.A. 28) and attempting to finance that political choice by extinguishing the meritorious claims of the petitioners. *See Virginia Department of Taxation Annual Report Fiscal Year 1991*, at 12. (App. G at 26a).

The court below also did not take into account the windfall that Virginia received during the forty-plus years this unlawful scheme was in effect.[20] Common sense suggests that the amount of taxes exacted for years before 1985 exceeds by several times any present refund obligation. Second, Virginia did not hesitate to accept that part of the Public Salary Tax of 1939 which benefitted its parochial interests. Under Title II of the Act, Virginia's retirees, as well as its then current employees, enjoyed total immunity from the federal income tax for all years prior to 1939. (App. B at 9a-12a). Some of its

[20] The court also did not consider the fact that Virginia's economy for years has been the beneficiary of a generous federal government. Recent statistical data reflect that in fiscal year 1989, the Department of Defense, alone, spent over $15 billion in the state. *See* Department of Defense ATLAS/DATA ABSTRACT FOR THE UNITED STATES AND SELECTED AREAS—FY 1989. (App. H at 29a).

citizens presently continue to enjoy that benefit. *See* note 18, *supra*. Having accepted the benefits of the Act, including its limited waiver of immunity, equity compels that Virginia now accept its burden. *Cf. Fahey v. Mallonee*, 332 U.S. 245 (1947) (one may not retain the benefits of an act while attacking its constitutionality).

In addition, the court failed to analyze the equities and reliance interests of the federal retirees, many of whom are elderly. The taxpayers here are not sophisticated multi-state business enterprises. They are average, law-abiding citizens who complied with the mandates of the Virginia law. For purposes of weighing the equities, they should not now be penalized by Virginia for complying with its laws and placing their trust in the political process. *Cf. Quill Corp. v. North Dakota*, 112 S. Ct. 1904, 1922 (1992) (White, J., dissenting) ("[W]e should insist that the appropriate way to challenge a tax as unconstitutional is to pay it . . . and then sue for declaratory judgment and refund."). Nor is it appropriate to deny these citizens their rights because they could not afford or risk the panoply of sanctions the State imposes for a refusal to comply with its tax laws. *See McKesson*, 496 U.S. at 38 n.21 (1990) ("[W]hen a tax is paid in order to avoid financial sanctions . . . the tax is paid under 'duress' . . . .").[21]

Moreover, it is totally inappropriate for a court to penalize an elderly citizen because that citizen could not afford to challenge that which the State should have known

[21] Individual income taxpayers who fail to comply with Virginia's income tax laws are subject to both civil and criminal sanctions. *See, e.g.*, Code §§ 58.1-347, 58.1-348, 58.1-350, 58.1-351, 58.1-496. (App. E at 19a-22a). The respondent takes great pride in its aggressive enforcement and audit programs. *See, e.g., Virginia Department of Taxation Annual Report 1989*, at 15 (noting that FY89 audit assessments were $10.7 million above the prior year). (App. G at 26a).

was, at best, suspect.[22] Indeed, even if Virginia's position otherwise had merit, these citizens should not be denied their federal rights. *Cf. Owen v. City of Independence*, 445 U.S. 622, 655, *reh'g denied*, 446 U.S. 993 (1980) ("Thus, even where some constitutional development could not have been foreseen . . . it is fairer to allocate any resulting financial loss to the inevitable costs of government borne by all taxpayers, than to allow its impact to be felt solely by those whose rights, albeit newly recognized, have been violated.").[23]

With respect to Virginia's 1989 tax collections after this Court's announcement of *Davis*, the legislature, consistent with the rule of *Welch v. Henry*, 305 U.S. 134, *reh'g denied*, 305 U.S. 675 (1938), had the ability to remedy the discrimination for taxes first due and returnable on May 1, 1989 on 1988 income. It consciously chose to defer the equalization of treatment for a year. (J.A. 28). Having waived the right to cure this part of the inequity, in no event should the State be permitted to retain the taxes first due on May 1, 1989 on 1988 income. *See R.H. Stearns Co. v. United States*, 291 U.S. 54, 61 (1934) (" 'He who prevents a thing from being done may not avail himself of the nonperformance which he has himself occasioned. . . .' ") (citation omitted).

[22] *See* Section of Taxation REPORT TO HOUSE OF DELEGATES, August, 1990 at 2 (noting that for years taxpayers have objected to perceived unfair and arbitrary treatment in compliance, assessment, and appeals of state and local taxes. (App. I at 30a). *Cf.* Shaviro, *An Economic and Political Look at Federalism in Taxation*, 90 Michigan L. Rev. 895, 924 (1992) ("[State] audits typically . . . tend to be influenced more by political and budgetary considerations . . . often take the form of nonspecific denials . . . requiring voluminous [taxpayer] documentation in response—and are conducted very much in light of the taxpayer's expected unwillingness to litigate . . . .").

[23] The court below also ignored that these citizens insured that their interests were advocated as an *amicus* before this Court in *Davis*. *See Davis*, 489 U.S. at 805.

The Supreme Court of Virginia's analysis of the equities also manifests a lack of understanding of the uniqueness of the personal income tax. Most states have long since adopted the federal standard of equity and conscience which favors the taxpayer. *See, e.g., Hackman v. Director of Revenue*, 771 S.W.2d 77 (Mo. 1989) (banc), *cert. denied*, 493 U.S. 1019 (1990); *Kuhn v. State, Dep't of Revenue*, 817 P.2d 101 (Colo. 1991), *cert. dismissed*, 112 S. Ct. 1925 (1992). This standard has its genesis in several of this Court's decisions involving federal taxation. As noted in *George Moore Ice Cream Co. v. Rose*, 289 U.S. 373 (1933), "[a] high-minded Government renounced an advantage that was felt to be ignoble, and set up a new standard of equity and conscience." *Id.* at 379. This standard expressly rejects such "ignoble" concepts as payment under protest, the power of the sovereign to retain invalid exactions, and the power to qualify the refund right by prospective decisions. Moreover, the federal refund right is conditioned or limited *solely* by the statute of limitations. The breadth of this right was described in *Jones v. Liberty Glass Co.*, 332 U.S. 524 (1947), *reh'g denied*, 333 U.S. 850 (1948):

> [W]e read the word 'overpayment' in its usual sense, as meaning any payment in excess of that which is properly due. Such an excess payment may be traced to an error in mathematics or in judgment or in interpretation of facts or law. And the error may be committed by the taxpayer or by the revenue agents. *Whatever the reason*, the payment of more than is rightfully due is what characterizes an overpayment.

Id. at 531 (emphasis added). It includes the right to recover " 'erroneously,' 'illegally,' or 'wrongfully' collected taxes." *United States v. Dalm*, 494 U.S. 596, 610 n.6, *reh'g denied*, 495 U.S. 941 (1990). This standard is based on sound considerations of public policy and seeks as its end to promote compliance with the income tax system. *See, e.g.*, REPORT AND RECOMMENDATIONS ON TAXPAYER

COMPLIANCE, American Bar Association Commission on Taxpayer Compliance, July, 1989, 41 Tax Lawyer 329 (1988).

Virginia's scheme of personal income taxation "piggybacks" on the federal scheme of taxation. Virginia has adopted the provisions of the Internal Revenue Code as the substantive state tax law, subject to limited statutory modifications. *See* Code §§ 58.1-322; 58.1-301 (App. E at 17a). In addition, the state refund right is not conditioned by a payment under protest provision and merely requires the timely filing of a refund claim. *See* Code §§ 58.1-1823; 58.1-1824; Reg. Sec. 630-2-499 D. (App. E at 18a-19a, 22a). Virginia's scheme of personal income taxation expressly grants its citizens the right to claim and receive refunds of Virginia income taxes which are attributable to intervening developments under the Internal Revenue Code. *Id.* Moreover, the period within which a refund may be claimed provides for an extended period of limitations where there is a change in the taxpayer's underlying federal income tax liability. *Id.* Indeed, in this case the State has waived all procedural bars to refunds. *See* Code § 58.1-1823B. (App. E at 18a).

Contrary to the decision below, the reliance and equitable interests of Virginia are meager. By virtue of its piggyback scheme of taxation, Virginia has expressly rendered its tax scheme subject to a host of unanticipated events, including unforeseen and unanticipated developments in the administrative rules of the Internal Revenue Service, enactments of Congress and federal decisional law. *See* Code § 58.1-301. (App. E at 17a). Stated another way, the unforeseen is an integral and anticipated element of the Virginia personal income tax law. Consequently, the contentions of the respondent below that the state refund right could be denied in this case because the refund liability was unforeseen is without merit.

Moreover, the decision of the court below to qualify the petitioners' refund rights under state law raises an in-

dependent constitutional ground for invalidating the decision. Here, the petitioners, who are seeking to enforce a constitutional right, are being required to satisfy and defeat the condition of the prospectivity defense, a condition not otherwise imposed on other Virginia income taxpayers.[24]

The petitioners' refund right cannot be subject to a defense based on the origin of the claim—the Constitution, when other Virginia income taxpayers' refund rights based on state law are not subject to or qualified by the defense. *See McKnett v. St. Louis & S.F. Ry. Co.*, 292 U.S. 230, 234 (1934) ("A state may not discriminate against rights arising under federal laws."). *See also Ward v. Board of County Comm'rs*, 253 U.S. 17, 22 (1920) (holding that a taxpayer could not be denied a tax refund on "non-federal grounds of decision that were without any fair or substantial support.").

Contrary to the impassioned plea of Virginia, none of the seven states (i.e., Missouri, New Mexico, West Virginia, Michigan, Louisiana, Colorado, Oregon) who have complied with their obligations to pay refunds in the wake of *Davis* has suffered the untoward results suggested by Virginia. Equity cannot excuse Virginia's obligation to pay the petitioners the refunds to which they are entitled. *See Patterson v. Shumate*, 112 S. Ct. at 2250.

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[24] For example, another taxpayer may challenge an item of federal adjusted gross income and by final judgment or settlement establish a new principle of law under the Internal Revenue Code. *See, e.g., Cottage Sav. Ass'n v. Commissioner*, 111 S. Ct. 1503 (1991). At the federal level, the taxpayer is entitled to a refund "whatever the reason." *Jones*, 332 U.S. at 531. That same taxpayer would then automatically be entitled to a refund of the Virginia tax attributable to that piggybacked item of income and, as a matter of Virginia law, could not be subject to the prospectivity defense, even if all the tests of the prospectivity defense were otherwise satisfied. *See* Reg. Sec. 630-2-499 D. Indeed, such a taxpayer would receive the benefit of an extended statute of limitations to make the claim. *Id.*

CONCLUSION

For the reasons set forth above, the court below erred in failing to enforce 4 U.S.C. § 111 in accordance with terms. Since the taxes collected by Virginia could "not be exacted," *Phillips Chem. Co. v. Dumas Indep. Sch. Dist.*, 361 U.S. 376, 387 (1960), in violation of the federal retirees' immunity and are therefore "void." *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744, 752 (1961), and since the State has taken no steps to remedy the unlawful tax, *amicus* urges that, as a matter of federal law, "to the extent [petitioners have] paid taxes pursuant to this invalid tax scheme, [they are] entitled to a refund." *See Davis*, 489 U.S. at 817; *Iowa-Des Moines Bank v. Bennett*, 284 U.S. 239, 247 (1931). Accordingly, *amicus* respectfully urges that the decision below be reversed and the case be remanded to the court below with instructions to order refunds as authorized under Code § 58.1-1823B. (App. E at 18a).

Respectfully submitted,

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July 16, 1992

APPENDICES

APPENDIX A

MEMBERS OF THE MILITARY COALITION

THE RETIRED OFFICERS ASSOCIATION (TROA)

The Retired Officers Association was founded in 1929 and has approximately 376,000 members. Membership in the Association is open to all past and present, active, reserve and retired commissioned and warrant officers in any of the seven uniformed services. The organization's mission is to support strong national defense and to represent membership on retirement and benefit issues before Congress.

AIR FORCE ASSOCIATION (AFA)

The Air Force Association was founded in 1946 and has approximately 200,000 members. Membership is open to anyone who has served in the U.S. armed forces. Other American citizens may affiliate as patrons. The organization's mission is to promote public understanding of aerospace issues and national security requirements to ensure strong support of the nation's defense and the men and women who serve in the U.S. Air Force.

AIR FORCE SERGEANTS ASSOCIATION (AFSA)

The Air Force Sergeants Association was founded in 1961. It has approximately 161,000 members and is composed of active and retired enlisted personnel in the Air Force, Air National Guard, Air Force Reserve, Army Air Corps and Army Air Force. Its members belong to 198 chapters throughout the world and the purpose of the organization is to serve as the voice of Air Force enlisted service members.

ASSOCIATION OF MILITARY SURGEONS OF THE UNITED STATES (AMSUS)

The Association of Military Surgeons of the United States received its Congressional Charter in 1908. Its membership consists of 17,000 members and is open to all

past and present commissioned officers or GS-9 and above civilians in the medical services of the United States Air Force, the United States Air Force Reserve, the United States Army, the United States Army Reserve, the Air National Guard, the Army National Guard, United States Navy, United States Navy Reserve, United States Coast Guard, the United States Public Health Service and the Veterans' Administration; officers of military medical services of other nations; and past and present medical consultants to the chiefs of the federal medical services. The purpose of the Association is to improve the nation's federal health care system.

ASSOCIATION OF U.S. ARMY (AUSA)

The Association of U.S. Army was founded in 1950 and has approximately 150,000 individual and 250 industrial members. Membership is open to all active, reserve and civilian personnel in the Army, and any person subscribing to the association's bylaws. The purpose of the organization is to foster public understanding and support of the Army and the people who serve in it.

CHIEF WARRANT AND WARRANT OFFICERS ASSOCIATION, U.S. COAST GUARD (CW & WOA)

The Chief Warrant and Warrant Officer's Association was founded in 1929 and has approximately 3,300 members. Membership is open to active duty, reserve and retired Coast Guard warrant and chief warrant officers. The association's purpose is to advance members' professional abilities.

COMMISSIONED OFFICERS ASSOCIATION OF THE U.S. PUBLIC HEALTH SERVICE, INC. (COA)

The Commissioned Officers Association of the U.S. Public Health Service was founded in 1937 and has approximately 7,000 members. Membership is open to active duty, retired, inactive reserve and former commissioned officers of the U.S. Public Health Service. The purpose of the organization is to ensure that the interests and welfare of commissioned officers of the USPHS are protected.

ENLISTED ASSOCIATION OF THE NATIONAL GUARD OF THE U.S. (EANGUS)

The Enlisted Association of the National Guard of the U.S. was founded in 1962 and has approximately 60,000 members. Membership is open to enlisted members of the National Guard through state associations and associate membership is open to all individuals through state associations. The purpose of the association is to promote and maintain adequate national security; and to foster the status, welfare and professionalism of enlisted members of the National Guard.

FLEET RESERVE ASSOCIATION (FRA)

The Fleet Reserve Association was founded in 1922. It has approximately 150,000 members who are active duty, retired enlisted personnel and commissioned officers with prior enlisted service in the Navy, Marine Corps and Coast Guard. The Association is chartered under the laws of Pennsylvania and its purpose is to represent its members on military personnel legislative matters before Congress.

MARINE CORPS LEAGUE (MCL)

The Marine Corps League was founded in 1923 and has approximately 31,000 members. Membership is open to those who served in the Marine Corps. The organization's mission is to preserve the traditions, to promote the interests of the Marine Corps, to voluntarily aid and render assistance to all Marines and former Marines, as well as to their widows and orphans.

MARINE CORPS RESERVE OFFICERS ASSOCIATION (MCROA)

The Marine Corps Reserve Officers Association was founded in 1928 and has approximately 5,500 members.

Membership is open to all Marine officers and officers of other U.S. services who served with Marines. The association's mission is to support and strengthen the Marine Corps, its reserve and reserve officers.

NATIONAL ASSOCIATION FOR UNIFORMED SERVICES/SOCIETY OF MILITARY WIDOWS (NAUS/SMW)

The National Association for Uniformed Services/ Society of Military Widows was founded in 1968 and has approximately 72,000 members. NAUS/SMW membership is open to all active, retired and former members of the uniformed services, their families and survivors. The association's mission is to represent members' interests by supporting legislation that upholds the security of the United States, sustains the morale of the uniformed services and provides fair and equitable consideration for all.

NATIONAL GUARD ASSOCIATION OF THE UNITED STATES (NGAUS)

The National Guard Association of the U.S. was founded in 1878 and has approximately 56,000 members. Membership is open to all present and former officers of the Army and Air National Guard, corporate and individual associate membership. The association's mission is to improve the readiness of the National Guard and to provide personnel benefits and entitlements for the half million members of the National Guard.

NATIONAL MILITARY FAMILY ASSOCIATION (NMFA)

The National Military Family Association was founded in 1969 and has approximately 6,250 members. Membership is open to active duty, retired and reserve component members of the seven uniformed services and their family members. The association's mission is to serve as an advocate for uniformed service families and to educate and inform them concerning issues affecting their lives.

NAVAL ENLISTED RESERVE ASSOCIATION (NERA)

The Naval Enlisted Reserve Association was founded in 1957. It has 16,000 members and its membership is open to active, inactive, and retired enlisted reservists in the Navy, Marine Corp and Coast Guard. The Association's mission is to focus on members' interests, morale and well-being, and readiness and training of sea service reserve forces.

NAVAL RESERVE ASSOCIATION (NRA)

The Naval Reserve Association was founded in 1954 and consists of 24,000 members. Membership in the Naval Reserve Association is open to active, inactive and retired Naval Reserve officers and its purpose is to maintain and strengthen the nation's defense by ensuring a continued strong Navy and Naval Reserve.

NAVY LEAGUE OF THE UNITED STATES (NLUS)

The Navy League of the United States was founded in 1902 and has approximately 75,000 members. Membership is open to civilians, military reservists and retirees. The league's mission is to maintain a strong U.S. maritime posture through support of the Navy, Marine Corps, Coast Guard and Merchant Marine.

NON COMMISSIONED OFFICERS ASSOCIATION OF THE UNITED STATES (NCOA)

The Non Commissioned Officers Association of the United States is a patriotic, civic and fraternal organization operating under Texas Corporate Charter. The Association was founded in 1960 and has more than 160,000 members. Its membership consists of active, reserve, retired or veterans of the United States armed forces in the grades E-4 thru E-9. The purpose of the Association is to promote and protect the rights and benefits of active duty and veteran non commissioned officers and petty officers in all five branches of the armed forces, and pro-

vide opportunities for them to join in patriotic, fraternal, social and benevolent activities.

RESERVE OFFICERS ASSOCIATION OF THE UNITED STATES (ROA)

The Reserve Officers Association of the United States was organized in 1922, and chartered by Congress in June 1950. Originally, the Reserve Officers Association consisted solely of Army Officers, Reserve Officers, National Guard Officers, and Retired Officers. Following World War II, the Reserve Officers Association expanded its membership to all services and it now has approximately 120,000 members. The purpose of the Association is to ensure an adequate total force of all services, including active and reserve components, and a force that is mobilization ready to meet any contingency.

THE JEWISH WAR VETERANS OF THE UNITED STATES OF AMERICA (JWV)

The Jewish War Veterans of the United States was founded in 1896 and has approximately 100,000 members. Membership is open to veterans of war time service of the Jewish faith. The organization's mission is service to veterans, Americanism, and to provide a voice on the Hill for veterans' legislation and benefits.

THE MILITARY CHAPLAINS ASSOCIATION (MCA)

The Military Chaplains Association was founded in 1925 and chartered by the 81st Congress in 1950. It has approximately 1,300 members. Membership is open to all chaplains of the Army, Navy, Air Force, VA and Civil Air Patrol, active duty, reserve, retired and former. The organization's mission is to safeguard and strengthen the forces of faith and morality of our nation; to perpetuate and to deepen the bonds of understanding and friendship in our military services; to preserve spiritual influence and interest in all members and veterans of the armed

forces; to uphold the Constitution of the United States; and to promote justice, peace and goodwill.

THE RETIRED ENLISTED ASSOCIATION (TREA)

The Retired Enlisted Association was founded in 1968 and consists of 50,000 members. Its membership is made up of enlisted retirees from all branches of the armed services and their surviving spouses. The mission of the association is to represent retired enlisted personnel and protect retiree military benefits.

U.S. ARMY WARRANT OFFICERS ASSOCIATION (USAWOA)

The U.S. Army Warrant Officers Association was founded in 1973 and has 4,000 members. Its members consist of National Guard active duty, reserve and retired Army warrant officers. The purpose of the association is to recommend improvement of the Army, and promote technical and professional information among warrant officers.

U.S. COAST GUARD CHIEF PETTY OFFICERS ASSOCIATION (CPOA)

The U.S. Coast Guard Chief Petty Officers Association was founded in 1969. Its 9,000 members are active, retired, and reserve Coast Guard chief petty officers. The mission of the Association is to promote the welfare of chief petty officers, to promote and protect the rights and benefits of all armed forces personnel and aid in Coast Guard recruiting.

APPENDIX B

PUBLIC SALARY TAX ACT OF 1939

AN ACT

Relating to the taxation of the compensation of public officers and employees.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Public Salary Tax Act of 1939".

TITLE I

SECTION 1. Section 22(a) of the Internal Revenue Code (relating to the definition of "gross income") is amended by inserting after the words "compensation for personal service" the following: ("including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing)".

SEC. 2. Section 116(b) of the Internal Revenue Code (exempting compensation of teachers in Alaska and Hawaii from income tax) is repealed.

SEC. 3. Section 22(a) of the Internal Revenue Code is amended by adding at the end thereof a new sentence to read as follows: "In the case of judges of courts of the United States who took office on or before June 6, 1932, the compensation received as such shall be included in gross income".

SEC. 4. The United States hereby consents to the taxation of compensation, received after December 31, 1938, for personal service as an officer or employee of the United States, any Territory or possession of political subdivision thereof, the District of Columbia, or any

agency or instrumentality of any one or more of the foregoing, by any duly constituted taxing authority having jurisdiction to tax such compensation, if such taxation does not discriminate against such officer or employee because of the source of such compensation.

TITLE II

SEC. 201. Any amount of income tax (including interest, additions-to-tax, and additional amounts) for any taxable year beginning prior to January 1, 1938, to the extent attributable to compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing—

(a) shall not be assessed, and no proceeding in court for the collection thereof shall be begun or prosecuted (unless pursuant to an assessment made prior to January 1, 1939);

(b) if assessed after December 31, 1938, the assessment shall be abated, and any amount collected in pursuance of such assessment shall be credited or refunded in the same manner as in the case of an income tax erroneously collected; and

(c) shall, if collected on or before the date of the enactment of this Act, be credited or refunded in the same manner as in the case of an income tax erroneously collected, in the following cases—

(1) Where a claim for refund of such amount was filed before January 19, 1939, and was not disallowed on or before the date of the enactment of this Act;

(2) Where such claim was so filed but has been disallowed and the time for beginning suit with respect thereto has not expired on the date of the enactment of this Act;

(3) Where a suit for the recovery of such amount is pending on the date of the enactment of this Act; and

(4) Where a petition to the Board of Tax Appeals has been filed with respect to such amount and the Board's decision has not become final before the date of the enactment of this Act.

SEC. 202. In the case of any taxable year beginning after December 31, 1937, and before January 1, 1939, compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, shall not be included in the gross income of any individual under Title I of the Revenue Act of 1938 and shall be exempt from taxation under such title, if such individual either—

(a) did not include in his return for a taxable year beginning after December 31, 1936, and before January 1, 1938, any amount as compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing; or

(b) did include any such amount in such return, but is entitled under section 201 of this Act to have the tax attributable thereto credited or refunded.

SEC. 203. Any amount of income tax (including interest, additions to tax, and additional amounts) collected on, before, or after the date of the enactment of this Act for any taxable year beginning prior to January 1, 1939, to the extent attributable to compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, shall be credited or refunded in the same manner as in the case of an income tax erroneously collected, if claim for refund with respect thereto is filed after January 18, 1939, and

the Commissioner of Internal Revenue, under regulations prescribed by him with the approval of the Secretary of the Treasury, finds that disallowance of such claim would result in the application of the doctrines in the cases of Helvering against Therrell (303 U.S. 218), Helvering against Gerhardt (304 U.S. 405), and Graves et al. against New York ex rel O'Keefe, decided March 27, 1939, extending the classes of officers and employees subject to Federal taxation.

SEC. 204. Neither section 201 nor section 203 shall apply in any case where the claim for refund, or the institution of the suit, or the filing of the petition with the Board was, at the time filed or begun, barred by the statute of limitations properly applicable thereto.

SEC. 205. Compensation shall not be considered as compensation within the meaning of sections 201, 202, and 203 to the extent that it is paid directly or indirectly by the United States or any agency or instrumentality thereof.

SEC. 206. The terms used in this Act shall have the same meaning as when used in Chapter 1 of the Internal Revenue Code.

SEC. 207. No collection of any tax (including interest, additions to tax, and penalties) imposed by any State, Territory, possession, or local taxing authority on the compensation, received before January 1, 1939, for personal service as an officer or employee of the United States or any agency or instrumentality thereof which is exempt from Federal income taxation and, if a corporate agency or instrumentality, is one (a) a majority of the stock of which is owned by or on behalf of the United States, or (b) the power to appoint or select a majority of the board of directors of which is exercisable by or on behalf of the United States, shall be made after the date of the enactment of this Act.

SEC. 208. This title shall not apply with respect to any officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, after the Secretary of the Treasury has determined and proclaimed that it is the policy of such State to collect from any individual any tax, interest, additions to tax, or penalties, on account of compensation received by such individual prior to January 1, 1939, for personal service as an officer or employee of the United States or any agency or instrumentality thereof. In making such determination the Secretary of the Treasury shall disregard the taxation of officers and employees of any corporate agency or instrumentality which is not exempt from Federal income taxation, or which if so exempt is one (a) a majority of the stock of which is not owned by or on behalf of the United States and (b) the power to appoint or select a majority of the board of directors of which is not exercisable by or on behalf of the United States.

SEC. 209. In the case of the judges of the Supreme Court, and of the inferior courts of the United States created under article III of the Constitution, who took office on or before June 6, 1932, the compensation received as such shall not be subject to income tax under the Revenue Act of 1938 or any prior revenue Act.

SEC. 210. For the purposes of this Act, the term "officer or employee" includes a member of a legislative body and a judge or officer of a court.

SEC. 211. If either title of this Act, or the application thereof to any person or circumstances, is held invalid, the other title of the Act shall not be affected thereby.

Approved, April 12, 1939.

APPENDIX C

OPINION OF ARIZONA ATTORNEY GENERAL
No. 60-9-L (1959)

December 28, 1959

Honorable David S. Wine
State Senator
Arizona State Senate
Phoenix, Arizona

Dear Senator Wine:

In response to your request regarding an opinion on the following question:

> "Is retirement compensation received by Federal Civil Service employees subject to the Arizona State income tax?",

it is the opinion of the Attorney General's office that said retirement compensation is subject to the Arizona State income tax.

It is our belief that federal civil service retirement income falls under that part of A.R.S. § 43-112(a), which is:

> "compensation for personal service, including personal service as an officer or employee of this state or the federal government, or any political division thereof or any agency or instrumentality of any one or more of the foregoing, * * *"

A.R.S. § 43-112(b) sets forth specifically all forms and types of income which are excluded from Arizona State income tax and federal retirement compensation does not fall thereunder.

In addition to the statutes above set forth, the Arizona State Tax Commission, in its Income Tax Regulation,

§ 112 (a)-2, has specifically included such retirement compensation as follows:

> "§ 112 (a)-2. *Compensation for Personal Services.*
>
> (a) Commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, pay of persons in the military or naval forces of the United States, retired pay of Federal and other officers, and pensions or retiring allowances paid by the United States (unless expressly exempt) * * * "

Since, by federal statute, civil service employees must contribute to their retirement compensation fund, it is the opinion of the State Tax Commission and this office concurs, that the retired federal civil service employees need not pay any Arizona State Income Tax on his retirement compensation received, until he receives back from the retirement fund a sum equal to that amount which he has contributed. Once he has received back a sum equal to what he had contributed, then thereafter all said income is wholly taxable. This situation is treated much the same as annuities are treated under our Arizona statutes. A.R.S. § 43-112 (b) (3).

If you have any further question, please feel free to contact this office.

Very truly yours,

WADE CHURCH
The Attorney General

STANLEY E. GOODFARB
Assistant Attorney General

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APPENDIX D

EXCERPTS FROM THE REPORT OF THE HOUSE FINANCE RETIREMENT SUBCOMMITTEE

To

THE GOVERNOR AND THE GENERAL ASSEMBLY OF VIRGINIA

DECEMBER, 1982

* * * *

The subcommittee was directed by Delegate Morrison to study the issue of desirability and feasibility of any possible changes in the treatment of retirement income for state individual income tax purposes. The subcommittee was to examine in particular the individual income tax treatment of military and civil service retirement benefits. The chairman also requested the subcommittee to examine the current Virginia retirement income tax credit. (pg. 4)

* * * *

Although further differences in treatment among the different classes of retirees can be listed, tax laws should not distinguish the components of compensation and why a person chooses a specific benefit package from another. The goal of the tax structure is to simply treat taxpayers fairly based on the benefits and income that they receive which, of course, they chose on their own. (pg. 8)

* * * *

The subcommittee has thoroughly explored the present treatment of retirement benefits in Virginia as well as the treatment of retirement benefits in other states. Moreover, the subcommittee has considered the concerns of numerous groups of retirees at a hearing held during the course of the study. (pg. 23)

* * * *

The subcommittee believes that to cure this inequity all retirees, age 62 and over, should be provided an exclusion of the first $3,000 of retirement benefits reduced by social security or any other non taxable retirement benefits. (pgs. 24-25)

* * * *

APPENDIX E

EXCERPTS FROM THE VIRGINIA INCOME TAX LAW AND REGULATIONS

Sec. 58.1-301. Conformity of terms to Internal Revenue Code.—A. Any terms used in this chapter shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required.

B. Any reference in this chapter to the laws of the United States relating to federal income taxes shall mean the provisions of the Internal Revenue Code of 1954, and amendments thereto, and other provisions of the laws of the United States relating to federal income taxes, as the same may be or become effective at any time or from time to time.

Sec. 58.1-322. Virginia taxable income of residents.—A. The Virginia taxable income of a resident individual means his federal adjusted gross income for the taxable year, which excludes combat pay for certain members of the Armed Forces of the United States as provided in § 112 of the Internal Revenue Code, as amended, and with the modifications specified in this section.

* * * *

D. In computing Virginia taxable income there shall be deducted from federal adjusted gross income:

1.a. The amount allowable for itemized deductions for federal income tax purpose where the taxpayer has elected for the taxable year to itemize deductions on his federal return, but reduced by the amount of income taxes imposed by the Commonwealth or any other taxing jurisdiction and deducted on such federal return and increased by an amount which, when added to the amount deducted under § 170 of the Internal Revenue Code for mileage, results

in a mileage deduction at the state level for such purposes at a rate of eighteen cents per mile; or

• • • •

Sec. 58.1-1823. Reassessment and refund upon filing of amended return.—A. Any person filing a tax return required for any tax administered by the Department of Taxation may, within three years from the last day prescribed by law for the timely filing of the return, or within sixty days from the final determination of any change or correction in the liability of the taxpayer for any federal tax upon which the state tax is based, whichever is later, file an amended return with the Department. If the Department is satisfied, by evidence submitted to it or otherwise, that the tax assessed and paid upon the original return exceeds the proper amount, the Department may reassess the taxpayer and order that any amount excessively paid be refunded to him. The Department may reduce such refund by the amount of any taxes, penalties and interest which are due for the period covered by the amended return, or any past-due taxes, penalties and interest which have been assessed within the appropriate period of limitations. Any order of the Department denying such reassessment and refund, or the failure of the Department to act thereon within three months shall, as to matters first raised by the amended return, be deemed as assessment for the purpose of enabling the taxpayer to pursue the remedies allowed under this chapter.

Sec. 58.1-1823B.*—Notwithstanding the time limitation contained in subsection A, an amended individual income tax return claiming a refund for taxes paid with respect to retirement or pension benefits received from a federal retirement system created by the federal government for any officer or employee of the United States, including the United States Civil Service, the United States Armed Forces, or any agency or subdivision thereof for any taxable year beginning on or after January 1, 1985, may be filed within one year from the entry of a final judicial

order of a court of competent jurisdiction not subject to further appeal resolving the issue of the application to Virginia income tax law of the United States Supreme Court decision in the case of *Davis v. Michigan Department of the Treasury*, 57 U.S.L.W. 4389 (U.S. March 28, 1989).

* As enacted by Senate Bill 2 (Chapter 1—1989 Special Session No. 2) and House Bill 2 (Chapter 2—1989 Special Session No. 2).

Sec. 58.1-1824. Protective claim for refund.—Any person who has paid an assessment of taxes administered by the Department of Taxation may preserve his judicial remedies by filing a claim for refund with the Tax Commissioner on forms prescribed by the Department within three years of the date such tax was assessed. Such taxpayer may, at any time before the end of one year after the date of the Tax Commissioner's decision on such claim, seek redress from the circuit court under § 58.1-1825. The Tax Commissioner may decide such claim on the merits in the manner provided in § 58.1-1822 for appeals under § 58.1-1821, or may, in his discretion, hold such claim without decision pending the conclusion of litigation affecting such claim. The fact that such claim is pending shall not be a bar to any other action under this chapter.

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Sec. 58.1-347. Penalty for failure to file income tax returns in time.—All individual or fiduciary income tax returns required by law to be filed with the commissioner of the revenue shall be filed with the commissioner of the revenue within the time required by this chapter, unless the time for filing such returns is extended by the Department. Upon all returns on which tax is due, filed with or assessed by the commissioner of the revenue after the time herein prescribed for the filing of returns, the commissioner of the revenue shall assess a penalty equal to

six percent of the amount of taxes assessable thereon, if the failure is not more than one month, with an additional six percent for each additional month or fraction thereof during which such failure to file continues, not exceeding thirty percent in the aggregate. Such penalty shall be collected in the same manner as is provided by law for the collection of other taxes.

(As amended by Chs. 629 and 642, Laws 1989; Chs. 316 and 331, Laws 1991, both effective July 1, 1991.)
*Prior to July 1, 1991, the rate was 5%.

Sec. 58.1-348. Criminal prosecution for failure or refusal to file return of income or for making false statement therein; limitation.—Notwithstanding any other provisions of this title and in addition to any other penalties provided by law, any individual or fiduciary required under this chapter to make a return of income, who willfully fails or refuses to make such return, at the time or times required by law, or who, with intent to defraud the Commonwealth, makes any false statement in any such return, shall be guilty of a Class 1 misdemeanor. A prosecution under this section shall be commenced within five years next after the commission of the offense.

Sec. 58.1-350. Procuring returns from delinquent individuals or fiduciaries.—The commissioner of the revenue shall secure a return from every delinquent individual or fiduciary within his jurisdiction, or if any such individual or fiduciary refuses to make a return or fails to make such return for fifteen days after the commissioner of the revenue calls upon him to do so, such commissioner shall, from the best information he can obtain, make an estimate of the income of such individual or fiduciary and report the same to the Department.

The commissioner of the revenue shall have authority to assess taxes, penalties and interest upon such estimate, and such taxes, penalties and interest shall be collected in

like manner as is provided by law for the collection of state taxes.

Sec. 58.1-351. When, where and how individual income taxes payable and collectible.—Each individual and fiduciary liable for income tax shall pay the same to the treasurer of the county or city with whose commissioner of the revenue the taxpayer files his return at the time fixed by law for filing the return. The full amount of the tax payable as shown on the face of the return shall be so paid. A taxpayer may file his return and pay his tax in full in the closing days of his taxable year provided he is able to prepare a complete return.

If any payment is not made in full when due, there shall be added to the entire tax or to any unpaid balance of the tax, a penalty of six percent of the amount thereof, if the failure is not more than one month, with an additional six percent for each additional month or fraction thereof during which such failure to pay continues, not exceeding thirty percent in the aggregate. The entire tax or any unpaid balance of the tax, together with such penalty, will immediately become collectible. Interest upon such tax or any unpaid balance of the tax, and on the accrued penalty, shall be added at a rate determined in accordance with § 58.1-15, from the date the tax or any unpaid balance of the tax, was originally due until paid. In the case of an additional tax assessed by the commissioner of the revenue under the provisions of § 58.1-307, if the return was made in good faith and the understatement of the amount in the return was not due to any fault of the taxpayer, there shall be no penalty on the additional tax because of such understatement, but interest shall be added to the amount of the deficiency at a rate determined in accordance with § 58.1-15, from the time the said return was required by law to be filed until paid.

The penalty under this section shall not be applicable to any month or fraction thereof for which the [individual]

is subject to the penalty imposed under § 58.1-347. In no event shall the total amount of penalty assessed under this section and under § 58.1-347 exceed thirty percent in the aggregate.

Sec. 58.1-496. Willful failure or refusal to file declaration of estimated tax, or making false and fraudulent statement, a misdemeanor.—Any person required under this article to file a declaration of estimated tax who willfully fails or refuses to file such declaration, at the time or times required by this article and any person who, with intent to defraud the Commonwealth, makes any false statement in any such declaration, shall be guilty of a Class 1 misdemeanor.

Reg. Sec. 630-2-499. Individual refunds; crediting overpayment against estimated tax.

* * * *

D. Statute of Limitations. No refund of any overpayment shall be made except upon discovery by the department or written application of the taxpayer within three years of the due date of the return for such taxable year or within sixty days from the final determination of any change or correction in the taxpayer's liability for federal income tax, whichever is later.

APPENDIX F

EXCERPTS FROM THE INTERNAL REVENUE CODE

[Sec. 111]

SEC. 111. RECOVERY OF TAX BENEFIT ITEMS.

[Sec. 111(a)]

(a) DEDUCTIONS.—Gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of tax imposed by this chapter.

[Sec. 164]

SEC. 164. TAXES.

[Sec. 164(a)]

(a) GENERAL RULE.—Except as otherwise provided in this section, the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:

(1) State and local, and foreign, real property taxes.

(2) State and local personal property taxes.

(3) State and local, and foreign, income, war profits, and excess profits taxes.

(4) The GST tax imposed on income distributions.

(5) The environmental tax imposed by section 59A.

In adidtion, there shall be allowed as a deduction State and local, and foreign, taxes not described in the preceding sentence which are paid or accrued within the taxable year in carrying on a trade or business or an ac-

tivity described in section 212 (relating to expenses for production of income). Notwithstanding the preceding sentence, any tax (not described in the first sentence of this subsection) which is paid or accrued by the taxpayer in connection with an acquisition or disposition of property shall be treated as part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition.

APPENDIX G

EXCERPTS FROM THE VIRGINIA DEPARTMENT OF TAXATION ANNUAL REPORTS

FISCAL YEAR 1988

* * * *

	Number of Refunds Processed (cumulative totals)		Average Refund Turnaround Time *	
	1988	1987	AR's	Other Refunds
January	29,097	1,195	3 days	1 week
February	395,388	94,757	5 days	5 weeks
March	915,070	434,224	5 days	3 weeks
April	1,336,460	824,162	7 days	3 weeks
May	1,614,288	1,367,871	13 days	4 weeks
June	1,780,498	1,672,357	5 days	2 weeks

* Turnaround times reflect the number of days it took to actually process Accelerated Refunds in the Tax Department, and not necessarily the number of days it took to receive a refund.

Accelerated Refund Statistics
As of July 1, 1988

Total Refunds Issued	1,780,498
Accelerated Refunds Filed (30.5% of all refunds issued were originally filed as AR's)	543,071
Accelerated Refunds Issued (85.1% of all AR's were issued as an AR)	462,282
Accelerated Refunds Denied (14.9% of all AR's filed were denied)	80,789
AR's Later Assessed (2.1% of AR's with processed returns)	7,232
Average Refund Amount—1987	$247.00
Average Refund Amount—1988	$202.00

(pg. 11)

* * * *

FISCAL YEAR 1989

* * * *

Estimated the additional general fund individual income tax windfall resulting from the Federal Tax Reform Act of 1986. The additional windfall was estimated to be $41.7 million for fiscal year 1988, and $58.4 million and $77.5 million for fiscal year 1989 and 1990 respectively. (pg. 5)

* * * *

Audit assessments for Fiscal Year 1989 were $10,671,346 above last year's assessments. Part of this success is attributable to several new audit programs and information sharing agreements designed to encourage voluntary tax compliance and increase collections. (pg. 15)

* * * *

FISCAL YEAR 1991

* * * *

Furthermore, the department's compliance programs have helped Virginia to maintain a stable tax structure and low tax rates. The state's income tax rates for individuals and corporations have not increased since 1972, and the sales and use tax rate has only increased by .05 percent since 1968. According to a Special Report issued by the Tax Foundation in October, 1991, Virginia's state tax burden is $10.85 below the national average tax burden of $64.87 per $1,000 of income, which is tied for the fifth lowest among the states based on fiscal year 1990 estimates. This low tax burden benefits all Virginia citizens. (pg. 12)

* * * *

APPENDIX H

EXCERPT FROM DoD ATLAS—FY 1989

DoD ESTIMATED PAYROLL AND PRIME CONTRACTS BY STATE

(THOUSANDS OF DOLLARS)
FISCAL YEAR 1989

State	Civilian Pay	Military Active Duty Pay	Reserve & National Guard Pay	Retired Military Pay	Total Compensation	Civil Functions Contracts	Military Functions Contracts	Total Contracts
Alabama	789,524	588,907	222,248	498,323	2,099,002	86,857	1,305,531	1,392,388
Alaska	193,392	567,974	24,774	64,562	850,702	17,458	522,337	539,795
Arizona	304,621	589,779	71,806	527,678	1,493,684	11,368	2,835,519	2,846,887
Arkansas	136,907	199,024	71,951	255,818	663,700	38,261	331,331	369,592
California	4,012,634	6,516,801	431,083	2,952,123	13,912,641	60,595	23,064,102	23,124,697
Colorado	363,176	1,008,837	114,248	563,590	2,039,851	6,899	2,921,402	2,928,301
Connecticut	146,690	287,806	49,112	135,908	637,616	1,269	6,081,021	6,082,290
Delaware	47,157	96,153	27,281	64,451	235,042	12,283	158,753	171,036
District of Columbia	564,469	386,633	98,044	66,730	1,115,876	6,652	1,229,312	1,235,964
Florida	1,030,474	2,215,970	153,749	2,092,292	5,492,485	28,356	4,424,027	4,452,383
Georgia	1,030,707	1,731,308	271,133	740,461	3,773,609	34,357	1,829,823	1,864,180
Hawaii	639,481	1,362,357	40,274	191,892	2,234,004	8,018	570,715	578,733
Idaho	34,934	112,486	39,122	98,955	285,497	667	74,122	74,789

State	Civilian Pay	Military Active Duty Pay	Reserve & National Guard Pay	Retired Military Pay	Total Compensation	Civil Functions Contracts	Military Contracts Functions	Total Contracts
Illinois	560,533	729,495	166,545	308,140	1,764,713	30,814	1,218,287	1,249,101
Indiana	456,254	141,030	184,216	185,580	966,580	9,714	1,753,363	1,763,077
Iowa	37,837	9,297	57,692	81,894	186,720	7,897	418,013	452,910
Kansas	180,175	623,131	188,094	192,962	1,162,362	6,754	948,213	954,967
Kentucky	350,445	1,093,166	102,836	210,812	1,757,259	23,573	309,151	332,724
Louisiana	237,848	686,722	111,654	307,564	1,343,788	221,848	1,471,639	1,693,487
Maine	307,916	182,335	31,304	118,118	639,673	385	369,626	370,011
Maryland	1,378,780	898,527	142,181	537,183	2,956,671	26,381	3,844,497	3,870,878
Massachusetts	367,011	283,266	145,629	244,936	1,040,842	13,459	8,744,008	8,757,467
Michigan	367,889	188,637	114,947	213,904	885,377	10,215	1,255,716	1,265,931
Minnesota	87,736	21,762	94,021	126,551	330,070	12,787	1,761,187	1,773,974
Mississippi	312,429	379,785	89,776	234,067	1,016,057	73,868	1,160,690	1,234,558
Missouri	630,224	422,642	187,227	317,805	1,557,989	42,655	6,239,994	6,282,549
Montana	37,566	93,064	26,769	59,910	217,309	2,461	78,075	80,536
Nebraska	113,564	343,581	37,941	125,349	620,435	4,663	217,021	221,684
Nevada	54,035	226,732	19,641	226,554	526,962	36	230,112	230,148
New Hampshire	45,718	99,595	21,008	114,726	281,047	6,722	471,076	477,798
New Jersey	711,011	493,703	145,965	279,003	1,629,682	108,900	3,284,471	3,393,371
New Mexico	290,290	349,384	49,515	261,623	950,812	9,356	615,676	625,032
New York	543,499	749,795	229,372	361,520	1,884,187	5,377	6,546,787	6,552,164
North Carolina	414,439	2,258,954	116,264	671,972	3,461,629	2,414	1,101,328	1,103,742
North Dakota	51,171	224,602	25,501	26,402	327,676	1,299	120,515	121,814
Ohio	1,091,153	342,997	150,893	369,835	1,954,878	15,955	5,053,413	5,069,358
Oklahoma	651,866	696,112	120,537	337,319	1,815,834	17,706	641,409	659,115

Oregon	98,312	22,374	54,359	221,917	386,962	7,013	171,513	178,526
Pennsylvania	1,474,544	224,904	306,218	457,779	2,463,445	63,893	2,764,139	2,828,032
Rhode Island	138,917	147,628	32,271	76,878	395,694	1,130	415,354	417,484
South Carolina	595,656	1,316,068	168,103	526,418	2,606,245	22,585	545,581	568,166
South Dakota	36,369	145,977	23,540	40,741	246,627	1,759	65,667	67,426
Tennessee	190,774	201,973	108,973	397,090	898,374	30,197	1,088,248	1,118,445
Texas	1,849,868	3,258,588	319,561	2,036,072	7,264,089	126,464	9,136,350	9,262,814
Utah	632,384	135,528	98,639	108,006	974,556	13,846	958,799	982,645
Vermont	17,544	1,992	23,798	33,297	76,631	764	162,595	163,359
Virginia	3,479,351	4,154,703	184,847	1,560,075	9,378,976	37,773	5,858,975	5,896,749
Washington	879,416	1,293,047	131,083	725,181	3,028,727	46,395	2,904,660	2,951,055
West Virginia	48,764	9,694	33,283	88,868	180,605	37,775	125,665	163,440
Wisconsin	94,037	23,889	171,867	125,980	415,773	7,361	1,073,428	1,080,789
Wyoming	32,276	81,796	13,199	36,624	163,895	123	67,013	67,136
Total U.S.	27,959,767	38,220,511	5,220,511	20,590,933	92,592,669	1,365,357	118,551,260	119,916,607

Prepared by: Washington Headquarters Services Directorate for Information Operations and Reports

APPENDIX I

AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

REPORT TO HOUSE OF DELEGATES

RECOMMENDATION

RESOLVED that the American Bar Association recommends to the state legislatures and municipal governing bodies of the United States that they adopt standards for state and local tax procedures that call for: (1) identical statutes of limitations for deficiencies and refunds; (2) identical interest rates for deficiencies and refunds; (3) no automatic imposition of penalties; (4) payment of disputed taxes only after the taxpayer is provided a hearing; (5) no seizure of property until after final adjudication; (6) a period of at least ninety days between the date of the deficiency notice and the date a notice of appeal is due; (7) the elimination of state fees to cover audit expenses; (8) providing taxpayers with due process; and (9) eliminating the need for taxpayers to relitigate identical legal issues in the same jurisdiction.

REPORT

For many years taxpayers have objected to perceived unfair and arbitrary treatment in compliance, assessment, and appeals of state and local taxes. When taxpayers perceive such treatment, voluntary compliance is seriously threatened. Addressing these concerns should increase respect for the tax system and improve the level of voluntary compliance.

Recent years have witnessed a significant increase in the amount of taxes raised at the state and local levels. For

example, for the twelve months ended March 1989, state and local governments collected $488.1 billion—a 6.3 percent increase over the twelve month period that ended March 1988. Increased tax revenues have resulted from tax increases (*e.g.*, rate increases, new taxes, broadening of existing tax bases) and enhanced enforcement of existing tax laws. The enhanced enforcement of state and local tax laws has increased the number of sensitive contacts between taxpayers and revenue collection agencies. The increase in contacts has heightened taxpayers' awareness of tax collection procedures. All of this has focussed discussion on the need for state tax policy makers and legislatures to give serious consideration to the procedural rights of taxpayers.

Consideration has led to very different responses. Some states have adopted procedural reforms through legislation while some states have done so through policy pronouncements from the revenue agency within the executive branch that is charged with implementing the tax laws. Further, some states have created a taxpayer advocate office, similar to the consumer advocate offices created during the 1960s and 1970s. Other differences are the ability to record interviews with auditors and the ability to sue the states. A comparison of all the laws that have passed is beyond the scope of this Report.

In September of 1988, California became the first state to adopt a taxpayers' bill of rights. California's legislation preceded the federal taxpayers' bills of rights. Subsequent to California's adoption, Arkansas, Illinois, Indiana, Kansas, Ohio, Oregon, and South Carolina also adopted taxpayer's bill of rights through legislation. Hawaii, Maryland, New York (state and city) and Texas adopted procedural reforms through policy pronouncements.

Over the years model legislation has been recommended that addressed procedural, due process and policy considerations in the state and local tax area. In addition to

these model acts endorsed by the ABA, it is appropriate to enumerate broad principles to guide state tax policy makers and legislatures.

A review of the procedural reforms adopted by thirteen states reveals that none of the thirteen states have adopted all of the principles recommended.

Specific statutory language is not recommended because it is viewed that: (i) it is almost impossible to draft language to amend or replace existing language that is in many instances scattered throughout the statutory framework of the various states; (ii) some states have already enacted certain of the recommended principles into their statutes and would find statutory language covering additional principles difficult to use; (iii) informal discussions with officials from various states and with national tax organizations reveal that they do not think that statutory language would be desirable in this circumstance; and, (iv) it would be desirable to affect the procedural tax reform process that is currently sweeping the states in a timely fashion.

PRINCIPLES

1. *Statutes of Limitations—Other than Fraud*

   State and local statutes of limitations for assessments, in cases other than those involving fraud, should be the same for deficiency assessments and refunds.

   Federal audit adjustments should open state and local income tax periods which are otherwise closed by statute only for those issues raised in the federal audit.

2. *Interest Rates*

   Interest rates for deficiencies and refunds should be the same. Interest is payment for the time value of money. It should not be imposed at a rate that punishes a taxpayer for failure to pay taxes timely. State and local efforts to encourage timely payment of taxes

and to punish non-compliance should be addressed by penalties and/or civil or criminal sanctions.

3. *Penalties*

   There should be no automatic imposition of penalties. Reasons for proposed penalties should be provided to the taxpayer by the taxing agency. The taxpayer should be given an opportunity to appeal, and penalties should be abated upon a showing by the taxpayer of reasonable cause. Penalties should not be enacted by legislatures to raise revenue—they should be designed solely to encourage compliance.

4. *Payment After Hearing*

   Taxpayers should not be required to post a bond or make a payment of a disputed tax until they have been afforded an opportunity for a hearing.

5. *Seizure of Property*

   A state or municipality should only be able to seize a taxpayer's property or levy against a taxpayer's assets after a final adjudication of the disputed amount or as a result of a jeopardy assessment where the probability of payment would be substantially reduced by the passage of time.

6. *Appeal Period*

   Taxpayers should not have to file a notice of appeal until at least ninety days have passed from the date on the notice of assessment. A reasonable period thereafter should be allowed for adequate preparation before a hearing is held and an opportunity should exist for the taxpayer to amend an appeal.

7. *Fees*

   Taxpayers should not have to pay the state or local government a fee for its expenses in auditing the taxpayers. Taxpayers should not have to pay the state

or local government's court costs or litigation fees if a taxpayer prevails in a dispute.

8. *Due Process*

Taxpayers should be afforded both an opportunity for a hearing before an independent tribunal and receive an appealable decision therefrom. Taxpayers should also have the opportunity to be represented by counsel and afforded other standards of due process like the use of discovery.

9. *Application of Decisions*

Once the highest court in a jurisdiction rules on a particular legal issue taxpayers should not have to relitigate the identical issue in the same jurisdiction.

COMMENTS ON PRINCIPLES

1. *Statutes of Limitation—Other than Fraud*

The underlying premise supporting civil statutes of limitation is that there is a period beyond which establishing the factual characteristics of a case becomes burdensome, difficult or impractical. This is, likewise, true with regard to issues arising under state and local tax laws.

Several states have statutes of limitation that allow the state and local government a longer period to assess a tax deficiency than the taxpayer has to claim a refund. This is perceived as creating an inequity, particularly when the taxpayer has not committed fraud.

In the area of taxation, the facts needed to establish the taxpayer's correct liability are generally reflected in the taxpayer's books and records. In many instances, taxpayers maintain books and records solely for the purposes of being able to substantiate prior

tax positions. Determining the period of time during which taxpayers should be required to maintain books and records is a subjective matter best left to the judgment of the legislature. However, once a taxpayer has been asked to maintain books and records and to continue being exposed to potential increases related to past tax periods, it seems only fair to require that the government also expose itself to the risk of having to refund taxes erroneously paid for a like period.

Because many states and local jurisdictions use federal taxable income or federal adjusted gross income as a starting point in determining state income or franchise taxes, a federal audit adjustment may trigger the need to file an amended state or local income tax return. Often, the federal audit adjustment is made after the statute of limitation has expired for auditing the state or local income tax return. When this occurs, the federal audit adjustment should not be used by the state or local government as an excuse to audit the taxpayer's state or local income tax return for issues other than those raised in a federal audit.

2. *Interest Rates*

Consistent with the treatment of interest applied to federal income tax deficiencies and refunds, some states and local governments apply a higher interest rate to deficiencies than they pay when taxes are refunded.

This appears to be an unjustifiable position if one accepts the premise that interest should be the payment for the time value of money. Interest should not be used to punish a taxpayer for the over- or underpayment of taxes—this is best done through penalties and other civil/criminal sanctions.

Some commentators have advanced the argument that higher interest rates are justified for deficiencies than for refunds because the state takes a credit risk with respect to the taxpayer's ability to pay the deficiency whereas the taxpayer presumably bears a smaller risk. Some taxpayers, however, are excellent credit risks, on a par with governmental bodies. It is inequitable to apply a higher interest rate to all taxpayers with deficiencies because a few are poor credit risks. If there is a question about a taxpayer's ability to pay a deficiency, seizure of property remedies are available. See comment on seizure of property, below.

3. *Penalties*

In recent years, the imposition of penalties has begun to be used as a revenue raising technique. Many tax jurisdictions automatically add penalty assessments to virtually all tax deficiencies. This is inappropriate if a taxpayer is neither notified of the reasons for the proposed penalties nor provided an opportunity to appeal such penalties. At a minimum, the tax agency should be required to have some basis for the penalty imposition. Further, penalties should be abated upon a showing of a reasonable cause.

4. *Payment After Hearing*

In many instances, taxpayers are required to post a bond or make payment of disputed taxes before being afforded an opportunity for an administrative appeal. This is inconsistent with federal income tax procedure and may often impose a severe hardship on taxpayers, especially when taxes erroneously collected from taxpayers are later refunded at below market interest rates.

5. *Seizure of Property*

Many state and local tax authorities abuse their power to seize property by exercising this power much too frequently. This power should be utilized only after

a final adjudication of the disputed amount or in instances where a designated governmental official determines that the probability of payment (*i.e.*; the collection for a deficiency) would be substantially reduced by the passage of time. The standards utilized to determine whether a jeopardy assessment is appropriate should be similar to those adopted by the federal government for purposes of the collection of federal taxes. Treasury Regulation 1.6851-1(1) (a) sets forth three conditions where a collection is in jeopardy; (i) the taxpayer is or appears to be "designing quickly" to leave the United States or go into hiding; (ii) the taxpayer is or appears to be "designing quickly" to place taxpayer's assets outside the reach of the government by removing, concealing, dissipating or transferring the assets; or, (iii) the taxpayer's financial solvency is or appears to be imperiled.

6. *Appeal Period*

A taxpayer's ability to appeal a tax assessment is basic to providing the taxpayer with due process. The regular delays encountered with mailing assessment notices and the amount of time necessary to evaluate such notices and determining whether an appeal is appropriate require that taxpayers be provided at least ninety days from the date on the assessment notice to file a notice of appeal. Shorter appeal periods often effectively eliminate any opportunity for due process.

As a related matter, once a notice of appeal is filed, taxpayers should be given time to amend such notice in order to perfect the appeal. Otherwise, a requirement that the taxpayer set forth his entire case may in some instances deprive taxpayers of the opportunity to analyze thoroughly the notice of assessment in conjunction with the taxpayer's books and records and other relevant information.

7. *Fees*

Some jurisdictions impose fees on taxpayers for expenses incurred in auditing the taxpayer and for legal costs incurred in defending tax appeals. While user fees may be an appropriate way of funding government services, it is unreasonable to charge taxpayers for the state's audit costs and it is also unreasonable to charge court costs if the taxpayer prevails in a dispute.

8. *Due Process*

Minimum standards of due process should be afforded a taxpayer when a tax is in dispute. Those standards include: (i) the opportunity to appeal an assessment before an independent tribunal; (ii) the opportunity to receive a decision from the independent tribunal which decision can then be appealed to a court; (iii) representation by counsel; (iv) the ability to call witnesses including government witnesses; and, (v) the availability of discovery to all parties.

It is believed that if the first level administrative appeal is provided by a part of an agency that has revenue collection responsibilities, then a de novo appeal should be provided to the taxpayer. In at least one jurisdiction (New York State) the revenue collection agency (*i.e.*, the Department of Taxation and Finance) cannot appeal unfavorable decisions from the Tax Appeals Tribunal to the courts. The concern is that this may have a chilling effect on the willingness of the tax tribunal to rule in favor of the taxpayer on the theory that the taxpayer can always appeal to the courts.

The burden of proof should generally be on the taxpayer, but, irrespective of who bears the burden of proof, the burden should ordinarily be met by a preponderance of the evidence.

9. *Application of Decisions*

State and local governments should establish procedures for implementing judicial resolutions of legal issues. Once the tax authority has lost a legal issue against a taxpayer, before the highest court in the state, there should exist some mechanism for ensuring that similarly situated taxpayers will not be faced with the litigation of legal issues that have already been resolved.

10. *Prospectivity*

There is a strong reluctance on the part of state and local governments to grant tax refunds when a tax has been held to be illegal or unconstitutional. Sometimes, there is a reluctance to refund taxes to the taxpayer litigant, and other times there is a reluctance to refund taxes to all similarly situated taxpayers unless those taxpayers have filed protective refund claims and/or lawsuits. The reluctance to grant refunds provides taxpayers with a disincentive to contest taxes and may serve to erode confidence in a voluntary system of tax compliance.

The issue of whether federal law requires state and local governments to provide taxpayers with retroactive relief when taxes have been exacted in violation of the commerce clause is before the U.S. Supreme Court in the case of *McKesson Corporation v. State of Florida* (October 1989 Term). While the tax authorities' reluctance to part with taxes that have been spent is understandable, the government's should either be prepared to refund taxes or they should escrow disputed taxes. However, no position is being taken on this issue, at this time, pending a review of the forthcoming Supreme Court decision.

Respectfully submitted,

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